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WEST GERMAN OBLIGATIONS UNDER THE EEC
MAY CHANGE THE STATUS
OF IMPORTANT EAST GERMAN BENEFITS
FROM INTERZONAL TRADE

DIRECTORATE OF INTELLIGENCE

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WEST GERMAN OBLIGATIONS UNDER THE EEC
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FROM INTERZONAL TRADE

The continuation of German interzonal trade in 1965 at its present level depends on the negotiation of several issues during the next few weeks, including the ticklish problem of the prices to be paid for East German deliveries of petroleum and grain to West Germany. East Germany has long received prices for both commodities that are much above the "world market" level because of the unique economic and political relationships between East and West Germany that allow the Ulbricht regime to benefit from official West German price supports, subsidies, and tariff protection. In 1963 this "bonus" may have amounted to more than \$30 million, or nearly half the total value of East German deliveries of these commodities to West Germany. The basis on which these subsidies were originally extended -- the practice of buying East German products at the same prices paid to domestic producers -- has been undercut, however, by West German obligations under the Common Market (the EEC). In 1963, West Germany eliminated or reduced all tariffs and subsidies on petroleum products, and the payment of subsidies on East German petroleum ceased to be a routine matter. After lengthy negotiations, West Germany finally agreed to continue to pay East Germany very nearly the same prices as before. The agreement was only for 1964, however, and will have to be renegotiated if it is to apply again in 1965.

If the West German grain subsidies are reduced in the face of French pressure for a common EEC grain price, the issue of prices for East German grain deliveries will be added to the problem

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1. Petroleum Subsidy and Tariff Benefits

East German shipments of petroleum products in interzonal trade are exempt from West German tariffs and receive preferential excise tax treatment. Through the tariff exemption, East Germany's products avoided a customs duty that has been higher than 100 percent ad valorem for imports of petroleum products from other sources.

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For example, in 1962 the average base price of diesel fuel imported into West Germany from Western sources was \$27.50 per ton, * while the duty was \$32.25 per ton.

Moreover, until this year the West Germans allowed East German suppliers an additional advantage by applying to imports from East Germany** the substantially lower "mineral oil" tax rate allowed for domestic hydrogenated petroleum products. Western supplies of petroleum products were taxed at the higher rate applicable to "nonhydrogenated" products.

These advantages gave East Germany the opportunity to undersell Western oil suppliers and to gain a much higher net return than the latter on sales of petroleum products to West Germany. On their exports of diesel fuel, for example, the East Germans were able to earn some \$47.25 more per ton than other suppliers, while underselling them by about \$1 per ton. It is estimated that, on its sales of roughly 625,500 tons of petroleum products to West Germany in 1962 (assuming East German production costs are approximately equal to those of the West), the Ulbricht regime gained tariff and tax benefits totaling more than \$25 million. (For a computation of price differentials for diesel fuel and for gasoline, see the following tabulation.)

	1962 US \$ per Ton	
	East Germany	Western Suppliers
Diesel fuel		
Base price	74.75 (at the border)	27.50 (CIF)
Customs duties	0.00	32.25
Mineral oil tax	41.13 (hydrogenation preferential, 15.75)	56.88
Final price	<u>115.88</u>	<u>116.63</u>
Gasoline		
Base price	64.50	28.75
Customs duties	0.00	32.25
Mineral oil tax	50.87 (hydrogenation preferential, 30.38)	81.25
Final price	<u>115.37</u>	<u>142.25</u>

* Tonnages are given in metric tons throughout this publication.

** Including some portion known to be of Soviet crude oil origin.

In 1962 the total gain was calculated as follows:

317,704 tons of diesel fuel

at \$74.75 equals \$23,748,374

at \$27.50 equals \$ 8,736,860

Difference: \$15,011,514

307,809 tons of gasoline

at \$64.50 equals \$19,853,680

at \$28.75 equals \$ 8,849,509

Difference: \$11,004,171

In late 1963, however, the Bonn government, in compliance with EEC regulations, passed a law, effective 1 January 1964, calling for a gradual abolition of the hydrogenation subsidy and the revocation of the tariff duty of \$32.25 (129 West German marks). To compensate for the loss of revenue attending the repeal of the customs duties, the West Germans raised the excise taxes on petroleum and petroleum products by the amounts of the former customs duties. This action had the effect of reducing East German profits by the amount of the former tariff, for the law made no provisions for special treatment of East German petroleum products. East German trade officials, asserting that the new law would cause their country an annual revenue loss of \$25 million to \$35 million, refused to accept the implicit cut in prices for East German petroleum products and threatened to suspend inter-zonal trade entirely. Bonn offered to grant a rebate of about \$19 million for 1964, which would compensate fully for the loss of customs protection to East Germany but not for the loss of the hydrogenation preferential. At first, East German officials balked at this offer, but on 21 January 1964 they agreed to the temporary solution offered by the West Germans. The disposition of the petroleum problem for 1965 and beyond, however, is still not settled.

2. Agricultural Price Support Benefits

East Germany also takes advantage of official price supports in West Germany that are designed to help the relatively inefficient West German farmer. Grains, milk, and sugar beets are sold at artificially high fixed prices, and imports of these commodities are subject to

moderate-to-high tariffs. Thus East Germany -- because its products are treated as domestic goods in a protected market -- can sell its grain in West Germany at prices which are considerably higher than it could get elsewhere in the non-Communist world but which are still below those charged by the subsidized West German farmers. One of the price-supported agricultural commodities is rye, which accounted for nearly 80 percent of the value of East German grain exports to West Germany in 1963. *

the average price received by the East Germans for 1 ton of rye exported to the Free World in 1963 was \$67.53 (at the official conversion rate for East German marks). Exports of rye to West Germany, however, earned an average of \$91.84 per ton compared with the 1962-63 average West German domestic market price of \$97.25 (389 West German marks), giving the East Germans a price advantage of \$24.31 per ton in the West German market compared with sales in other Western markets. The East Germans can undercut the West German producers of rye in their own market and still sell their rye at a price more than one-third higher than the average price that they receive for rye in Free World markets. Assuming a similar price differential for other grains, the West German price supports could have meant a bonus of about \$5 million to East Germany for its total exports of grain to West Germany in 1963.

Along with the West German farmers, East Germany may soon lose its preferential position in the West German grain market if the increased French pressure on West Germany for agreement on uniform grain prices for the EEC is successful. France is attempting to force a showdown on the grain price issue, with its recent threat to refrain from participation in the EEC unless the West German government agrees to a settlement soon. Even if the price level ultimately agreed on is higher than that sought by France, which is the EEC's lowest cost producer, it will still be below the subsidized price paid to West Germany's high-cost farmers. Hence the West German government, mindful of the farm vote, has so far stoutly resisted efforts to establish a common EEC grain price disadvantageous to West German producers.

A reduction in the West German grain subsidy also would adversely affect East Germany. Although still considered as domestic West German

* East Germany is a net importer of grain. The rye that East Germany shipped to West Germany in 1963 was almost entirely of Soviet origin.

trade, and hence enjoying the protection of the EEC's common external tariff, East German exports would have to be reduced in price to be competitive with the French and other EEC suppliers unless some special compensatory arrangements are extended to East Germany. This matter has become of marked importance to the East Germans because of last year's increase in the annual East German grain quota from \$5 million to \$17 million.

3. Prospects

It is well-established West German policy to grant generous treatment to East Germany in the matter of prices in German interzonal trade. West Germany is the only market in which the terms of trade, relative to world market prices, are advantageous to East Germany. In West German eyes the maintenance and expansion of German interzonal trade have helped -- at the very least -- to discourage East German interference with traffic between West Germany and West Berlin. At present the desire not to disturb the status quo in German interzonal trade is reinforced by recent East German concessions and by a shift of West German opinion in favor of a flexible policy toward Eastern Europe. It thus seems likely that Bonn again will agree to subsidize East German deliveries of oil, especially since this oil is destined for West Berlin. The manner of further subsidy of East German grain deliveries will depend on the outcome of the current EEC negotiations on the common grain policy.

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